

**TREASURY - GENERAL**

**STATE INVESTMENT COUNCIL**

**U.S. Common and Preferred Stocks and Issues Convertible  
Into Common Stocks**

**Proposed Amendments: Subchapter Title; N.J.A.C. 17:16-41.1 and 41.3**

**Proposed Repeal: N.J.A.C. 17:16-41.4**

Authorized By: State Investment Council, Peter A. Langerman, Director,  
Division of Investment

Authority: N.J.S.A. 52:18A-91

Calendar Reference: See Summary below for explanation of exception to calendar  
requirement.

Proposal Number: PRN 2004-123

Submit comments by June 4, 2004 to:

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The agency proposal follows:

Summary

The proposed amendments to N.J.A.C. 17:16-41.1 and 41.3 and the repeal of N.J.A.C. 17:16-41.4 would eliminate the Approved Common and Preferred Stocks and Issues Convertible into Common Stocks List; permit the Division to invest in equities and securities that trade on an exchange in the United States or the over-the-counter market; permit the Division to retain exchange-traded funds whose capitalization may fall below the criteria subsequent to purchase; allow the Division to retain any distribution received as a result of a corporate action, even if the security does not meet the requirements of the subchapter; and require that only the full Council be notified at a regular meeting when



the combined market value of equities in Common Pension Funds A and D reach or exceed 68 percent of the total market value.

Given the thousands of individual investments comprising the Approved Lists, it has become unrealistic to expect that Council members will have extensive knowledge of all of these investments. Eliminating the Approved Lists at N.J.A.C. 17:16-41.1 (c), while at the same time providing criteria for selection of individual investments, gives recognition to the fact that the Council relies on the Division of Investment to have this in-depth knowledge and to select particular investments. Since the Division of Investment will be reporting to the Council on investment activities, the Council shall continue to be able to fulfill its role of monitoring of investments contained in the various portfolios.

Pursuant to the proposed amendments at N.J.A.C. 17:16-41.1 (b), the Division of Investment is authorized to purchase only investments that meet the requirements set forth in the subchapter. However, there may arise, from time to time, certain unique circumstances where the Division wishes to purchase an investment that does not meet the requirements set forth in the subchapter. In such event, the proposed amendments provide that the Division could present justification to the Council, and the Council would have the authority to approve the purchase on a case-by-case basis.

Because the Division is providing a 60-day comment period on this notice of proposal, this notice is exempt from the rulemaking calendar requirement pursuant to N.J.A.C. 1:30-3.3(a)5.

#### Social Impact

There shall be no social impact from the proposed amendments and repeal, although the long term economic effects could benefit the State's taxpayers.

#### Economic Impact

The proposed amendments and repeal may provide an opportunity to earn greater returns as well as to broaden the diversification for the State-administered funds.



#### Federal Standards Statement

A Federal standards analysis is not required because the investment policy rules of the Division of Investment are under the auspices of the State Investment Council, and are not subject to any Federal requirements or standards.

#### Jobs Impact

The State Investment Council and the Division of Investment do not anticipate that any jobs will be generated or lost by virtue of the proposed amendments and repeal.

#### Agriculture Industry Impact

The proposed amendments and repeal shall have no impact on the agriculture industry.

#### Regulatory Flexibility Statement

A regulatory flexibility analysis is not required, since the proposed amendments and repeal impose no requirements on small businesses as the term is defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq., but regulate only the Director of the Division of Investment.

#### Smart Growth Impact

The proposed amendments and repeal are not anticipated to have an impact on the achievement of smart growth and implementation of the State Development and Redevelopment Plan.

Full text of the proposal follows (additions indicated in boldface **thus**; deletions indicated in brackets [thus]):

#### **SUBCHAPTER 41. U.S. COMMON AND PREFERRED STOCKS AND ISSUES CONVERTIBLE INTO COMMON STOCKS AND EXCHANGE-TRADED FUNDS**



17:16-41.1 Permissible investments

(a) **Subject to the limitations contained in this subchapter**, the stock shall be issued by a company or bank incorporated or organized under the laws of the United States or any State thereof or of the District of Columbia, or by any international company that is included in the S&P 500 Composite Index.

(b) **Subject to the limitations contained in this subchapter, the common stock and securities shall trade on an exchange in the United States or the over-the-counter market.**

[(b)] (c) Permissible investments include exchange-traded funds which invest in companies incorporated or organized under the laws of the United States, are traded on the New York or American Stock Exchanges or the over-the-counter markets, and have a minimum market capitalization of \$100 million. For the purposes of this subchapter, exchange-traded funds shall be considered as common stocks in determining all applicable limitations contained within this subchapter. **Subsequent to purchase, if capitalization falls below \$100 million, the investment does not have to be sold.**

[(c)] (c) The Director shall submit a list of common stocks and exchange-traded funds to the Council for its approval. Such lists may be amended or enlarged from time to time subject to the Council's approval and shall be designated the "Approved Common and Preferred Stock and Convertible Securities List" and the "Approved List of Domestic Equity Exchange-traded Funds," respectively.]

[(d)] (d) The Director shall only select issues of common stocks from the "Approved Common and Preferred Stock and Convertible Securities List" or exchange-traded funds from the "Approved List of Domestic Equity Exchange-traded Funds" to be recommended by the pension funds.]

(d) **Notwithstanding the restrictions contained in this subchapter, the Council may approve the purchase of common stocks or exchange-traded funds on a case-by-case basis.**

(e) Notwithstanding the above restrictions, the Director may:

1. (No change.)
2. Purchase the preferred stock, whether convertible or not, of a company, the stock of which qualifies for investment [and is on the "Approved Common and Preferred Stock and Convertible Securities List"] **under this subchapter;**
3. Purchase the convertible issue of a company, the common stock of which qualifies for investment [and is on the "Approved Common and Preferred Stock and Convertible Securities List"] **under this subchapter;**



4. Purchase a debt issue of a company, the common stock of which qualifies for investment [and is on the “Approved Common and Preferred Stock and Convertible Securities List”] **under this subchapter**; for the purpose of this rule all such debt purchased shall be considered as common stock in determining all applicable limitations contained herein. Not more than three percent of the total assets held in Common Pension Fund A shall be invested in such debt; [and]
5. Purchase up to one percent of any eligible fund’s assets in new public offerings of companies without prior approval of the State Investment Council provided, however, approval will be sought at the next regularly scheduled Council meeting **in the event the security does not subsequently meet the requirements of this subchapter.** [In the event] **If** approval is not granted, the securities will be sold within three months of the Council’s disapproval[.] ; **and**
6. **Retain any distribution received as a result of a corporate action, even if the security does not meet the requirements of this subchapter.**

#### 17:16-41.3 Limitations

(a) The market value of total investments in common and preferred stock and issues convertible into common stock, both domestic, as permitted herein, and international, as permitted in N.J.A.C. 17:16-44, for any one of the pension funds listed in N.J.A.C. 17:16-41.2 shall not exceed 70 percent of the market value of such fund, with the exception of Common Pension Funds A and D. When the combined market value of the common and preferred stock and issues convertible into common stock, held by a pension fund, either directly or in Common Pension Funds A and D, reaches or exceeds 68 percent of the total market value of the pension fund as of the end of a period used for evaluating unit values of participation, then the Council shall be notified at a regularly scheduled meeting of the Council [or its Executive Committee]. When the combined market value of the common and preferred stock and issues convertible into common stock, held by a pension fund, either directly or in Common Pension Funds A and D, exceeds 70 percent of the total market value of the respective fund, then the Division may have a six-month period of grace to reduce the level of participation of the fund below the 70 percent level, except that the period of grace may be extended for additional four month periods with the approval of the Council.

(b) – (c) (No change.)



17:16-41.4 [Approved Common Stock and Exchange-traded Funds Lists] **(Reserved)**

[(a) The “Approved Common and Preferred Stock and Convertible Securities List” is a list of those companies whose stocks can be purchased by the eligible funds. Additions to or deletions from the List shall be made by the Council, in its discretion, based, respectively, upon the presence or absence of the following:

1. The company shall have growth in revenues and earnings which exceed growth in the Gross Domestic Product;
2. The company shall have a strong market franchise, unique products and proven marketing capability;
3. The company’s management shall have demonstrated the ability to preserve profit margins, to avoid earnings surprises and to take the needed initiatives to preserve and improve upon the company’s strengths;
4. The company shall have capitalization which is not heavily leveraged, thereby allowing it more flexibility to finance future expansion;
5. The company shall not be unduly capital intensive, which might expose it to the necessities of raising capital at times when capital markets are unduly expensive;
6. The company shall demonstrate that it can generate capital internally for growth;
7. The market for the company’s shares shall have enough liquidity to permit the orderly acquisition and disposition of a full position; and
8. The company shall have conservative accounting practices.

(b) Companies which are not in conformance with (a) 1 through 8 above may be added to or retained on the List, on a case-by-case basis, if the Council determines that the company is otherwise financially secure and presents a sound investment opportunity.

(c) The “Approved List of Domestic Equity Exchange-traded Funds” is a list of domestic equity exchange-traded funds that can be purchased by the eligible funds. Additions to or deletions from the list shall be made by the Council.]